



MICHAEL J. MURPHY
State Treasurer

First Quarter 2004

The QUARTERLY

Local Government Investment Pool

Finally a better snapshot: Non-farm payroll

The Non-Farm Payroll

After three months of weak Non-Farm Payroll numbers (NFP), the economy generated 308,000 jobs in March. Meanwhile, the two prior months' jobs numbers were revised upward to average 171,000 per month, bringing jobs in line with other strong economic numbers and indicating overall improvement.

The last piece of our economic puzzle has finally surfaced, a solace to most economists.

Could this be the start of a more concrete path towards economic growth? Or is it another false dawn? Fed governors unanimously agreed that one number does not make a trend, but a series of over 100,000 jobs a month could erase their doubts about a lukewarm economic recovery.

A scenario of higher interest rates could actually surface, as FOMC members have warned that the current highly accommodative stance cannot continue forever. We could be near the boiling point of producing considerable economic steam if jobs continue to gain traction in the next few months.

The advent of sustainable recovery?

Are there reasons to believe the economy is finally on track to deliver self-sustaining growth numbers? Economists want to believe that this time, all indicators are moving in a very positive direction. For a few months, a host of economic numbers has actually shown what appears to be real improvement.

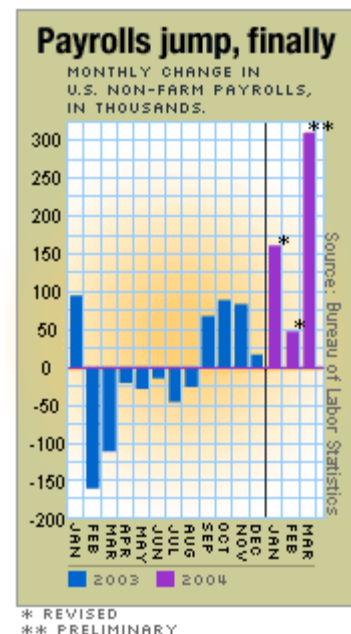
The payroll report confirmed that businesses have been increasing output both through capital investments and, now, hiring. A few quarters ago most companies were content to squeeze more output through labor productiv-

ity. However, if the jobs report continues its overall growth, it sends investors a message that real demand is pushing the economy to-

ward near-term growth. The economic indicators prior to March's NFP number were highly suspicious, because recent upbeat economic readings failed to give market watchers certainty

that the economy was actually creating jobs.

Some attribute better economic output to labor productivity gains, which have been consistently high — even during periods of economic weakness last year. Although the revision to January and February jobs lifted actual numbers, other job measures, e.g., wage rates and workweek, were disappointing. The government's Bureau of Economic Analysis reported that wages and salaries have not gone up at all over the past three years. U.S. personal income rose 4.6 percent, which is less than the 4.8 percent increase in the price index of personal consumption.



LGIP staff

Michael J. Murphy
State Treasurer
(360) 902-9001

Michael Colleran
Assistant Treasurer
(360) 902-9002

Douglas Extine
Deputy Treasurer
(360) 902-9012

Lisa Hennessy
Investment Officer
(360) 902-9013

Jen Thun
LGIP Administrator
1-800-331-3284

Mary Pheasant
Administrative Support
(360) 902-9004

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Market summary

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The Fed's current position, in accord with most economists, is that economic recovery is underway. The recent strength of the Institute for Supply Management (ISM) survey, which measures manufacturing production, orders, and backlog, points to a robust growth that hasn't been seen in several years. The ISM survey noted that technology related products and basic materials have been experiencing tightness in supply, even with increased production. A surge in export orders, brought about by the weak dollar, is also helping the U.S. economy boost its already healthy market demand.

Retail sales have been phenomenal, with evidence that even department store sales, which have been perennial laggards in the industry, are experiencing better-than-average sales growth. Consumption, as measured by household spending, remains on track to achieve a growth rate of better than four percent, affirming the robust overall demand.

March retail sales proved consumers were unperturbed by rising fuel costs. Retail sales grew 1.8 percent in March, the biggest rise in a year. With expectations at only 0.7 percent, there is increased speculation of rising pressure on the Fed to raise interest rates.

March's retail sales figure suggested consumer confidence did not reflect consumption patterns for the same period. Substantial revisions to January and February retail sales numbers showed consumers continued to spend, indicating a more positive attitude than consumer confidence numbers suggested.

Housing and construction numbers also recovered after cooling off in February due to inclement weather. Although the housing market index is down from its October peak, the level remains relatively high, signifying sustainable growth.

The jump in nonfinancial corporate profits to over 34 percent does not belie the fact that our economy is in a much better shape compared to 2003. The Q1 2004 Conference

Board CEO survey has predicted higher employment this year, attesting to most companies' willingness to hire additional workers for the rest of 2004. Most investors will probably wait until stronger job numbers appear next month to determine the veracity of this kind of survey. A steady increase in job numbers would confirm that the current economic growth has all cylinders fired up to attain the much-awaited recovery.

Will inflation rear its ugly head?

There are legitimate concerns about inflation creeping up as highlighted by the most recent CPI numbers. Headline inflation and core CPI rose 0.5 and 0.4 percent, respectively, a stronger-than-expected rise on all fronts. On a year-on-year basis, the growth in headline and core CPI amounted to 1.7 and 1.6 percent, respectively. Stronger CPI and job numbers will eventually create fodder for more Fed-tightening talk as market watchers cannot ignore the stronger numbers that might influence the Fed's policy.

The accommodative monetary policy of the Fed has benefited U.S. households tremendously through lower borrowing costs. Although households have kept financial burdens manageable, a sudden rise in U.S. interest rates could temper spending habits, which could be disastrous to the economy's fragile recovery. The pace of debt creation has risen to nearly 11 percent, but U.S. household assets have also gone up due to rising equity and real estate markets. This has kept the household balance sheet somewhat better compared to 2003.

Savings rate and real wage gains have been stagnant which may be the reason Fed Governor Ferguson cautioned market watchers to restrain their jubilation over a single employment number. Consumer spending could falter, which might dampen the rosy forecast of most investors and cancel out the stronger employment and CPI numbers.

LGIP Advisory Committee

Dani Burton

Klickitat County Treasurer
(509) 773-4664

Stan Finkelstein

Assn. of Washington Cities
(360) 753-4137

Lisa Frazier

Mason County Treasurer
(360) 427-9670 (Ext 484)

Chuck Greenough

State Board for Community and Technical Colleges
(360) 704-4380

Paula Henderson

City of Des Moines
(206) 870-6512

Lynn Hills

Port of Bremerton
(360) 674-2381

Richard Patrick

City of Burlington
(360) 755-0531

Shelley Pearson

Kitsap Co. Investment Offcr.
(360) 337-7139

Barbara Stephenson

Kitsap County Treasurer
(360) 337-7136

Dan Underwood

City of Richland
(509) 942-7302

Linda Wolverton

Spokane County Treasurer
(509) 477-4786

Mark Wyman

Snohomish County PUD
(425) 783-8317

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Notes from the March 26 advisory committee meeting

The LGIP Advisory Committee met March 26. A brief update was given on the net LGIP returns for January and February 2004. The fed funds rate remains at 1 percent. The LGIP has outperformed its benchmark, iMoneynet, Inc., by an average of 45 basis points.

The strategy for the management of the LGIP portfolio was discussed. Currently, the portfolio has an average life of 50-55 days, maintaining a neutral position. While some economists believe that the fed will begin tightening in August, many believe the first tightening will not occur until 2005.

The LGIP balance, which is currently at \$4.9 billion, is higher than anticipated for this stage in the property tax cycle. Advisory committee members discussed their investment strategies, general market conditions,

and their outlooks for future LGIP balances.

Treasurer Murphy announced the expiring appointments of advisory committee members Chuck Greenough, Dan Underwood, Mark Wyman and Kathy Turnbull as of April 30, 2004. Chuck Greenough was reappointed by Treasurer Murphy. Dan Underwood was reappointed by the Washington Finance Officers Association; Mark Wyman was reappointed by the Public Utility Districts Association; and Lisa Frazier, Mason County Treasurer, was appointed by the Washington State Association of County Treasurers (WSACT). These appointments are all for three-year terms which will expire on April 30, 2007. Dani Burton, Klickitat County Treasurer, was appointed by WSACT to complete the final two years of the

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Contacts:

Sue Melvin
Equipment specialist
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Kristi Wolgamot
Real estate specialist
360-902-9020

Pam Johnson
LOCAL specialist
360-902-9021

Market Summary

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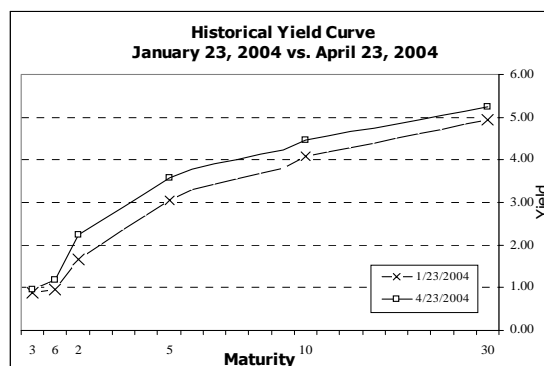
Is the market factoring in a Fed tightening?

Judging by Fed pronouncements, much stronger job numbers are necessary before we see any Fed action. Fed governors appear to be concerned about traction and whether the labor market improvements are "fundamental." The bond market, however, is already pricing in that the Fed will start raising rates as early as June this year. The jobs number (NFP), on which the market has placed considerable importance in the past few months,

needs to produce a consistent growth trend before the market should get worried.

The bond market reacted immediately to March employment and CPI numbers. Yields rose 57 basis points across the (from 1-3 years) curve, reminiscent of the backup in yields during July 2003. Most money managers were prepared for a backup, however, as they maintained overwhelmingly high short-duration positions over their respective bogeys. Greenspan's testimony to the Senate Banking Committee also added speculation of rising interest rates as he said the threat of deflation is no longer an issue and that he feels confident about the U.S. economy.

The net LGIP rate held at 1.06 percent for the first two months of 2004, then fell to 1.03 percent in March. During the first quarter there were few investments inside of 90 days providing positive carry. However, with the market's current attitude of an impending interest rate hike by the Fed, the yield curve has become slightly steeper in the short end.



Investing 101: Performance benchmarks

The following article is part of the "Investing 101" educational series, which focuses on basic investment issues. We hope you find these articles informative and helpful.

How well is your investment program performing? As the investment officer, how well are you performing? Good? Bad? Average? Compared to what? These are questions investment program managers and their officers should be asking — and they can only be answered if there is an appropriate performance benchmark to measure against.

Performance benchmarks are an important aid in planning and implementing an investment program. An appropriate benchmark can be a valuable means to monitor the performance of the program or to evaluate the performance of the portfolio manager. In this article we'll discuss objectives of performance benchmarks, steps in choosing a benchmark, and problems that may arise from using an inappropriate benchmark.

Before an appropriate benchmark can be selected, the objectives and parameters of the investment program must be set. Once these are defined, the next step is to decide what type of performance the benchmark will be used to measure. Will you use it to assess the value of your investment program relative to leaving all of your money in a short-term investment? Or will it be used to evaluate the performance of the investment officer? Keep in mind these are two very different objectives and, for most entities, will likely involve the selection of two different benchmarks.

Once the objective has been agreed upon, begin the search for an appropriate index or measure to use as the benchmark. Because the LGIP's investment guidelines are patterned after SEC registered 2a-7 money market funds, OST began the search for a benchmark with a field of several hundred privately managed 2a-7 funds. Then a group of approximately 100 funds with similar investment parameters was selected to use as a benchmark for the LGIP. Both gross rates (before fees) and net rates (after fees) for these funds are available. The LGIP uses both rates, but for very different purposes.

The net rates are reported in the quarterly newsletter (see page 10). Net rates provide an "apples to apples" comparison for LGIP participants because they compare the performance of the LGIP relative to the private money funds. However, because of the lower fees charged by the LGIP, net rates are not a useful benchmark in measuring the performance of the LGIP portfolio manager. Instead, the performance of the portfolio manager is evaluated against the benchmark on a gross rate basis, which accurately compares the performance of the individual portfolio managers.

There are instances in which a benchmark that does not provide a truly equivalent comparison of performance can still be used appropriately. Let's say your objective is to show the value added by having an internal investment program as opposed to leaving all your money in the LGIP, or some other short-term investment vehicle. In this case, using the LGIP as a benchmark for your entity's investment program, while not an *equivalent* benchmark, is nonetheless an *appropriate* benchmark.

However, use caution when using a benchmark that is not entirely comparable. Particular problems can arise from using a benchmark with a targeted average life different than your portfolio. As we have discussed in past newsletters, average life determines the speed at which a portfolio reprices to the current market, and that a portfolio with a short average life will reprice more quickly than one with a longer average life. Consequently, when rates go up, the shorter portfolio will outperform a longer portfolio, while the opposite occurs when rates go down.

Over a market cycle, the longer portfolio should outperform the shorter portfolio. However, if your time horizon is very short the opposite may occur. Take, for example, a situation where the LGIP, with a maximum average life of 90 days, is used as a benchmark for a portfolio with a maximum average life of one year. One should expect there will be time periods where the LGIP will outperform, but *over a mar-*

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Investing 101

continued

ket cycle the portfolio with a longer average life should outperform the LGIP. Individuals who oversee their investment program must understand that this is to be expected, and it is not an indication that the portfolio manager is doing something "wrong" or performing poorly.

It is inappropriate to use a benchmark with a shorter average life when evaluating the performance of the portfolio manager. Inherently, the longer portfolio would be expected to outperform the shorter one irregardless of the ability/performance of the portfolio manager. Also, overall performance may be negatively impacted due to poor investment decisions made in an effort to outperform the shorter portfolio.

Performance benchmarks are an important component of any investment program. A carefully chosen appropriate benchmark will clearly answer the question, "How is my portfolio performing?" The proper benchmark is also a helpful tool in evaluating the performance of the portfolio manager. Here we have provided a rather general discussion of performance benchmarks. In the next article we'll look at specific examples of some common benchmarks and how you might develop your own customized benchmark.

Minutes

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term of Virginia "Jenny" Zacher, who resigned from the committee. That term will expire April 30, 2006.

Treasurer Murphy presented a certificate of appreciation to Kathy Turnbull for serving on the advisory committee from September 2001 to April 30, 2004.

LGIP participants are being encouraged to use TM\$. Currently, about 62 percent of all transactions are made through the automated system. Some of the attractive features of TM\$ include: 1) it is the quickest way to obtain monthly statements; 2) the transaction amounts can be changed up until 10 a.m. on a daily basis; and 3) account information can be accessed and viewed online.

The fax system used to send monthly statements to LGIP participants failed recently. A new system has been implemented and will be monitored to ensure it is working properly when the monthly statements are sent.

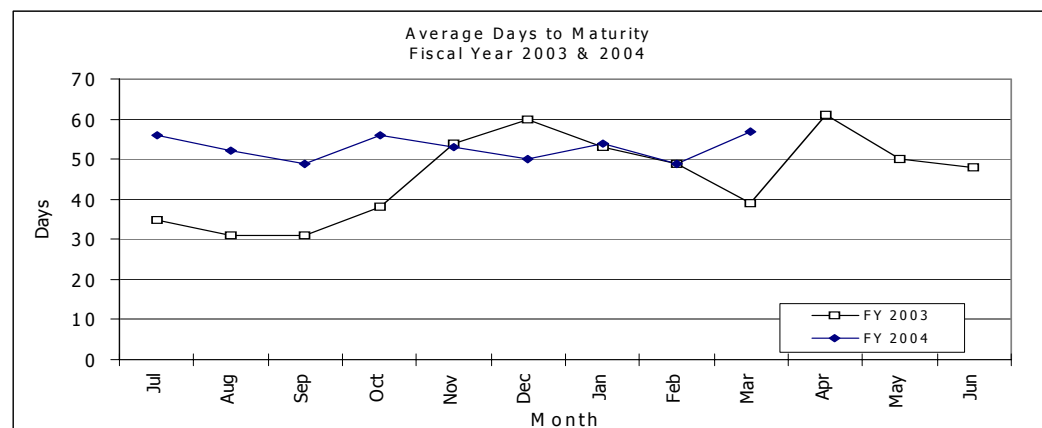
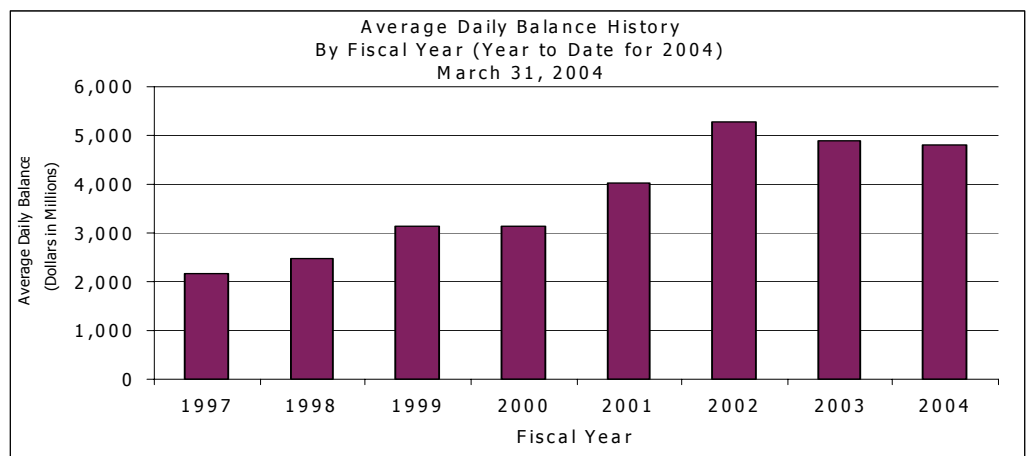
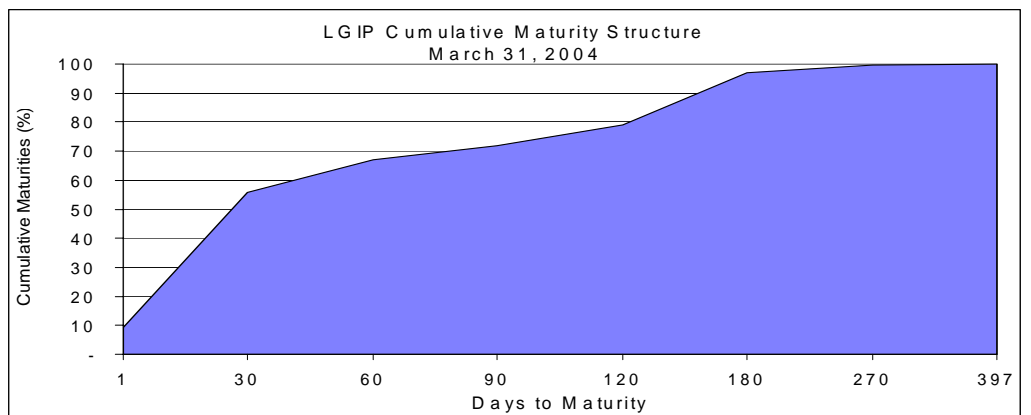
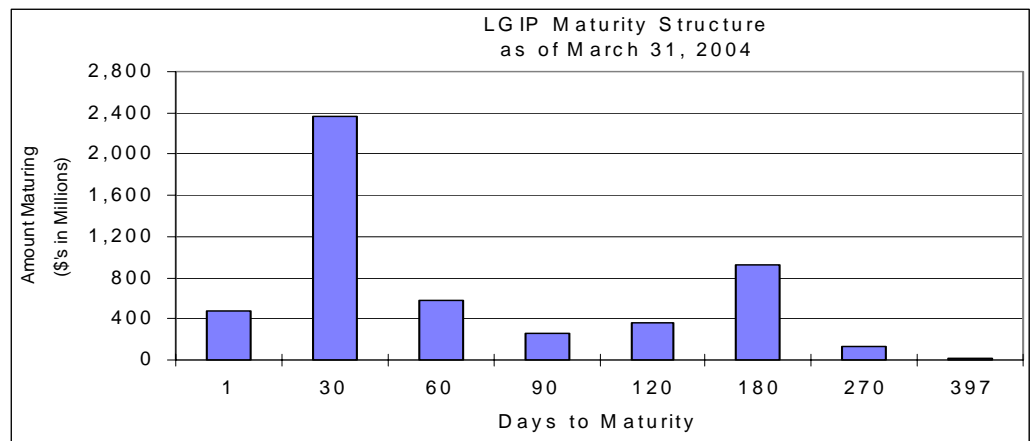
OST staff discussed the OST business continuity plan and opportunities they have had to test the plan, such as the 2001 earthquake. The role of TM\$ was also mentioned.

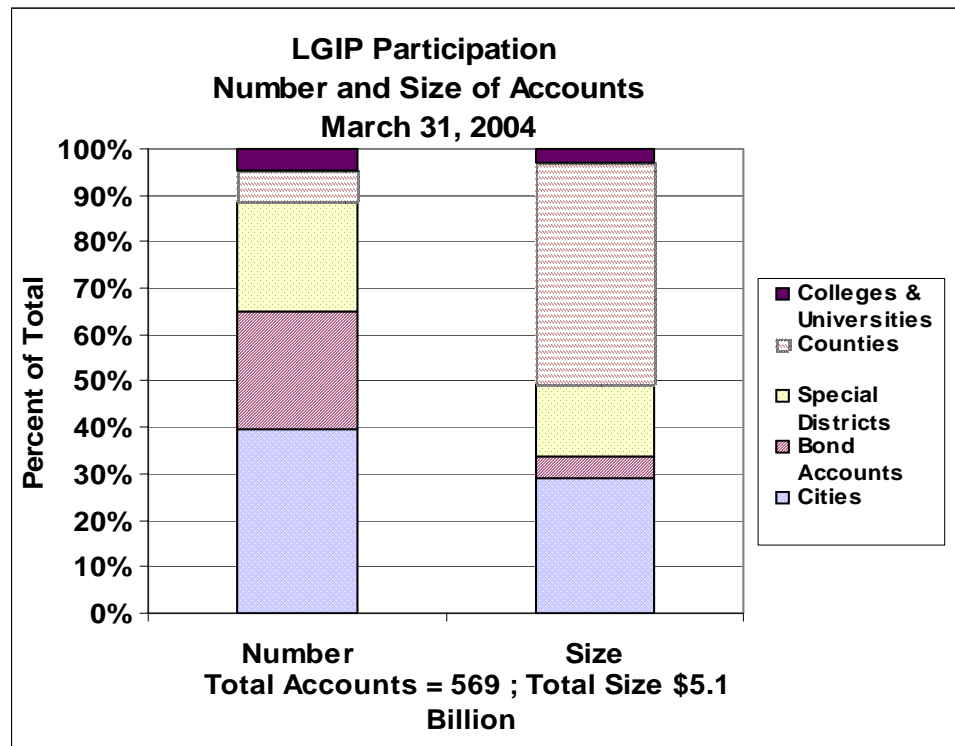
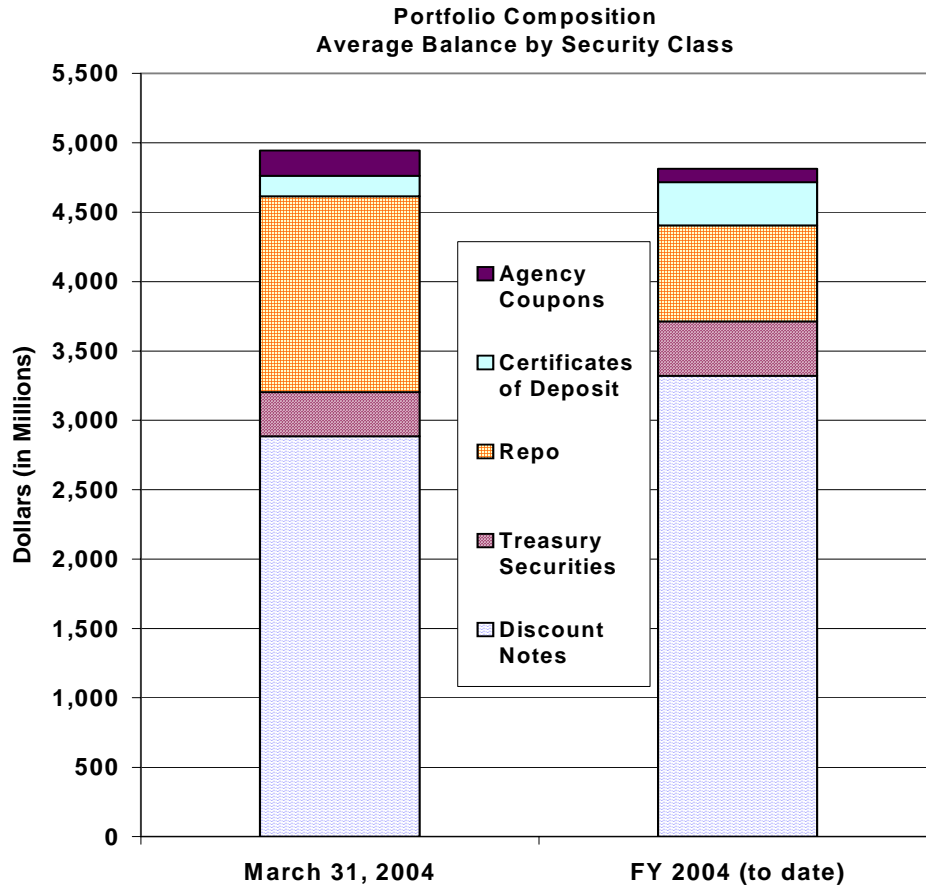
The FY 2004 budget was reviewed. Through January 2004, the fees and overdraft charges of \$1,004,615 were \$185,615 higher than the preliminary estimate. This is attributed to higher-than-expected balances in

the LGIP. Actual expenses through January 2004 of \$329,464 were \$21,703 below the original estimate. Adjusting for actuals, the estimated rebate of \$802,000 for FY 2004 has now been increased by \$207,318 to \$1,009,318.

The LGIP Investment Policy is reviewed on an annual basis. LGIP investment guidelines are based on the Securities and Exchange Commission (SEC) rules for Rule 2a-7 money market funds. One area where the LGIP and 2a-7 parameters differ is the maximum final maturity of floating or variable rate securities. OST is exploring modifying the LGIP investment policy to mirror the SEC guidelines, which would involve some revisions to the current policy. If OST decides to pursue changes to the policy, they will be brought to the Advisory Committee at the July meeting. However, OST wanted to make advisory committee members aware of the potential changes before the July meeting.

It was agreed that proposed revisions and the rationale for making them will be sent to committee members well in advance of the next meeting date so members have time to review any proposed changes before the meeting.





From the LGIP Administrator's Desk

By Jen Thun

I admit I have missed hearing some of your voices, but I am so glad to see more participants using the Treasury Management System (TM\$). Currently, about 62 percent of daily LGIP transactions are entered using TM\$. For those of you who are not using TM\$, why not!?

I am sometimes surprised to find participants are not aware of TM\$ and all the options it has to offer. So, here is a refresher course on TM\$ and what it can do for you.

Transaction entry: TM\$ allows authorized users to enter transactions over the Internet. You can even enter future dated transactions by *retrieving* the future effective date. TM\$ will also allow you to *change your transaction* before 10 a.m., as long as it does not violate any of the business rules (i.e. no net changes over \$1 million after 9 a.m.). To update a transaction simply pull up the entry, type over the previous amount and save. You can even browse past transactions.

Balances: TM\$ will give you a snapshot of your LGIP account balance.

Participant information: TM\$ will allow you to view information provided on your LGIP Authorization Form, such as address, persons authorized to make transactions, and banking information. This is a quick and easy way to see if it's time to update your information.

Reports: TM\$ will allow you to view and print various reports including account ledgers, account summaries, and monthly statements. TM\$ is by far the fastest way to get your monthly earnings figure. As soon as I have allocated interest, your statement is ready on TM\$, whereas you might be waiting hours or even days to get your statement by fax or mail. TM\$ also has help screens throughout to assist you in navigating the system.

We are very proud of TM\$ and the convenience it offers LGIP participants. We have received lots of positive feedback on the system from participants and I encourage those who have not used it to give it a try. All you need is to fill out the TM\$ Logon Authorization form which you can find on our website – www.tre.wa.gov – or I would be happy to send it to you. If you have any questions regarding TM\$ or suggestions on how we can improve it for you, feel free to call me at 1-800-331-3284.

LGIP Holiday Schedule for 2004

The Local Government Investment Pool will be closed on the following days:

Monday	May 31	Memorial Day
Monday	July 5	Independence Day
Monday	September 6	Labor Day
Monday	October 11	Columbus Day
Thursday	November 11	Veteran's Day
Thurs/Fri	November 25-26	Thanksgiving holiday
Friday	December 24	Christmas
Friday	December 31	New Year's

Washington State Local Government Investment Pool
Position and Compliance Report
as of 3/31/2004
(Settlement Date Basis)

LGIP Portfolio Holdings

	Cost	Percentage of Portfolio
U. S. Agencies	\$ 219,043,921	4.28
U. S. Callables	20,000,000	0.39
Certificate of Deposit	104,200,000	2.04
Discount Notes	2,727,272,768	53.31
Interest Bearing Bank Deposits	50,347,143	0.98
Repurchase Agreements	1,655,020,000	32.35
U.S. Treasuries	140,609,091	2.75
U.S. Treasury Bills	199,509,961	3.90
*Total Excluding Securities Lending	5,116,002,885	100.00

Securities Lending Holdings

Repurchase Agreements	421,793,606
Total Securities Lending	421,793,606

**Total Investments &
Certificates of Deposit**

\$	<u>5,537,796,491</u>
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Policy Limitations

*The policy limitations include investment of cash collateral by a securities lending agent calculated as percentages of the portfolio holdings Total Excluding Securities Lending.**

Size Limitations

	Portfolio Holdings	Percentage	Policy Percentage
Agency Callables	20,000,000	0.39	10%
Certificate of Deposit	104,200,000	2.04	10%
Leverage - Sec Lend + Rev Repo	413,322,562	8.08	30%

Maturity Limitations (Days)

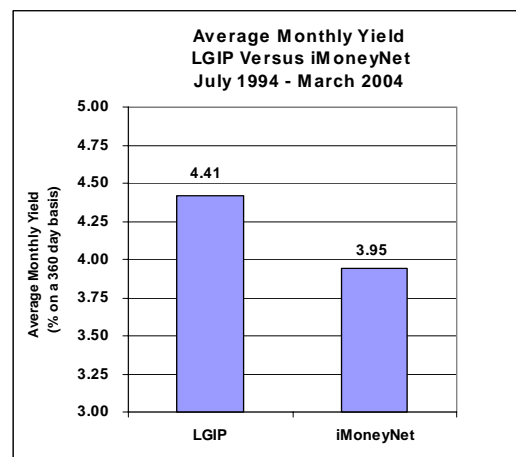
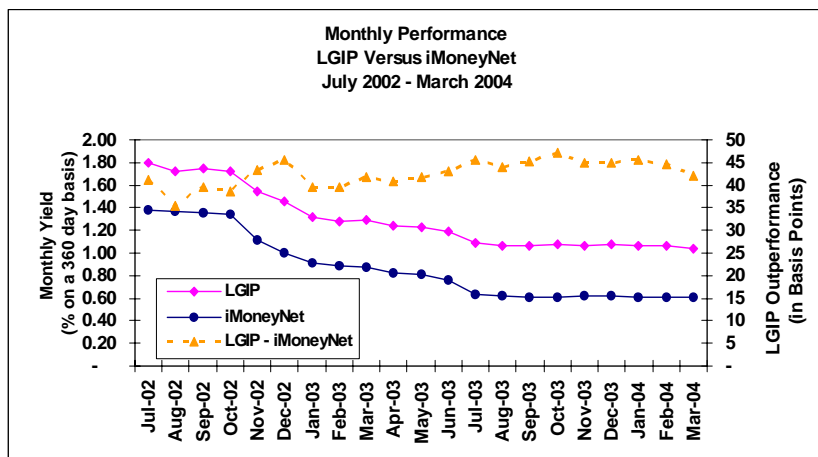
	Currently	Policy
Average Life	57	90
Maximum Maturity	324	397
Maximum Maturity of Repos	20	180
Maximum Maturity of Reverse Repos	0	90

Repo Limits Per Dealer

	March 31, 2004	Total Repo Percentage (20% limit)	Term Repo Percentage (10% limit)	Projected Redemptions 4/1/2004	Projected Position 4/1/2004
Banc America Securities	\$ 285,000,000	5.57%	0.00%	285,000,000	-
Bear Stearns & Co.	475,000,000	9.28%	9.28%	-	475,000,000
Daiwa Bank	77,996,340	1.52%	0.00%	77,996,340	-
Goldman Sachs	371,870,108	7.27%	3.91%	171,870,108	200,000,000
Lehman Brothers Inc.	145,020,000	2.83%	0.00%	145,020,000	-
Merrill Lynch	200,000,000	3.91%	3.91%	-	200,000,000
Morgan Stanley Dean Witt	521,927,158	10.20%	6.84%	171,927,158	350,000,000
Total	\$ <u>2,076,813,606</u>			<u>851,813,606</u>	<u>1,225,000,000</u>

LGIP Performance Comparison

iMoneyNet, Inc.¹ versus Local Government Investment Pool



The chart on the left shows a monthly comparison from July 2002 through March 2004 and how the LGIP has consistently outperformed the benchmark.

The chart on the right shows an average monthly yield comparison from July 1994 to March 2004. The LGIP net rate of return has outperformed its benchmark during that time period by an average of 47.0 basis points. This translates into the LGIP earning \$150.67 million over what the average comparable private money fund would have generated.

¹ Average Net Rate of Return of Government Only/Institutional Only Money Market Funds, Money Market Insight, iMoneyNet, Inc., Westborough, MA. This benchmark is comprised of privately managed money market funds similar in composition and investment guidelines to the LGIP.

Local Government Investment Pool

STATEMENT OF NET ASSETS

March 31, 2004

Assets

Investments, at Amortized Cost:	
Repurchase Agreements	1,655,020,000
U.S. Agency Callables	20,000,000
U.S. Agency Coupons	219,043,921
U.S. Agency Discount Notes	2,727,272,768
U.S. Treasury Securities	340,119,052
Total Excluding Securities Lending & Securities Purchased But Not Settled	4,961,455,741

Securities Lending Investments, at amortized cost:	
Repurchase Agreements	421,793,606
Total Investments (Settlement Date Basis)	5,383,249,347
Total Investments (Trade Date Basis)	5,383,249,347

Interest Bearing Bank Deposits	50,347,143
Certificates of Deposit	104,200,000
Cash	73
Interest Receivable	5,570,781
Total Other Assets	160,117,997
Total Assets	5,543,367,344

Liabilities

Accrued Expenses	290,359
Obligations under Securities Lending Agreement	421,793,606
Total Liabilities	422,083,965

Net Assets	\$ 5,121,283,379
Participant Net Asset Value, Price per Unit	\$ 1.00

Total Amortized Cost - Settlement Date Basis	\$ 5,537,796,490
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QUARTER AT A GLANCE January 1, 2004 to March 31, 2004

Total investment purchases:	\$ 34,036,057,172
Total investment sales:	\$ 1,933,552,269
Total investment maturities:	\$ 31,933,273,796
Total net income:	\$ 13,229,475
Net of realized gains and losses:	\$ 475,609
Net Portfolio yield (360-day basis):	
January	1.0671%
February	1.0595%
March	1.0334%
Average weighted days to maturity:	57 days

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